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Warning Signs Are There for Italy

- By IRWIN STELZER



The good news is that Italy, euroland's third largest economy, is not like Greece or Ireland. No major housing bust, no major banking implosion, at least not yet. The bad news is that Italy is like Portugal, which also has so far escaped housing and banking problems of Greco-Irish proportions, but is growing so slowly that its tax revenues might fall short of covering its IOUs. The worse news is that Italy's economy is almost half-again as large as Spain's, and troubled Spain is a country deemed too big to fail, but which the euro zone can't command sufficient resources to save.



Reuters

Mario Draghi, Governor of Banca d'Italia, has fears for Italian growth.

Italy's relatively good financial position is due to some competent bank regulators and its talented central bank governor, Mario Draghi. Unfortunately, their success does not mean that all is well. Mr. Draghi

complains that Italy is "incapable of growing at a sustained rate ... a clear loss of competitiveness compared to our main European partners." From 1998 to 2008, German productivity increased 22%, France's 18%, and Italy's a mere 3%. If productivity growth is not increased, Italy's economy will be unable to grow at faster than the 1% rate the government projects for this year and next. In which case, says the Organization for European Economic Co-operation, tax revenues will decline, and Italy will not be able to meet its deficit target.

But the new businesses needed to generate innovation, productivity and growth are hard pressed to get off the ground. Credit Italy's entrepreneur-blockage to the spaghetti-like red tape, corruption, a tax structure that maximizes incentives to evasion, and an overweening government bureaucracy.

Compounding the problem is the depressed view Italy's business community has of its government. Prime Minister Silvio Berlusconi, his widely reported dalliances with young women not as amusing to Italians as they are to the rest of the world, will face a confidence vote on Dec. 14. Italian businessmen with whom I have spoken believe that no matter the outcome of that vote they will end up with a government still incapable of clearing the garbage from gangster-controlled Naples, or saving Italy's crumbling art treasures, or pushing through needed structural reforms of the economy.

Add a quite justified feeling of helplessness. Italians cannot set the exchange rate they need to become competitive, especially with China's under-valued renminbi: Italy long ago gave up the lira for the euro. They cannot set the interest rate appropriate to their economic circumstance: that is set by the European Central Bank largely to suit the Germans. They cannot control their energy costs: the cartel that is the Organization of Petroleum Exporting Countries determines the cost of energy in a country overly dependent on oil.

The Italian economy is driven in large part by the manufacture of high-quality consumer goods produced by small and medium-sized family-owned enterprises. These labor-intensive industries are finding that the market for high-price quality goods is being eaten away by lower-quality and far lower-priced goods

made by Chinese laborers both in the People's Republic and in Italy.

In Venice, designers and makers of the city's famous glassware doubt they will long survive the competition of made-by-Chinese knock-offs. Vicenza's gold-jewelry manufacturing industry is also shrinking as Asian makers take over that market. These labor-intensive industries and their family-owned companies are not dissimilar to Portugal's shoe industry, which is being wiped out by cheaper Chinese imports.

Competition comes not only from far-away Asia. Many products once turned out by Italian craftsman are now manufactured in Italy by colonies of Chinese immigrants working hours and at pay that Italians are unable or unwilling to match. Worse still, I am told that both in China and in Italy the workers toil on machines that were designed in Italy, sold to China, and then copied for use by the low-paid Chinese workers.

There is a flip side to this coin. The streets of many major Italian cities are crowded with Chinese shoppers depleting the shelves of big name-brand retailers such as Gucci and Prada. By their shopping bags shall ye know them. Italian-made unbranded goods can't lure the international-brand-obsessed Chinese into their stores. So Italian manufacturers and shop keepers doubt their ability to survive.

Greece, Ireland, Portugal and Spain are paying premiums of between 5% and 7+% over German 10-year bunds. Italy, which recently paid a premium of only about 1.7%, might be next in investors' sights unless it can get its economy growing at better than the 1% rate it is now managing. After all, with debt equal to 120% of gross domestic product, Italy is more heavily in hock than Portugal, its total debt running at 85% of GDP. And Portugal's World Bank ease-of-doing-business rank of 31 puts it just below Israel and the Netherlands, while Italy is ranked 80th, meaning it is tougher for an entrepreneur to do business in Italy than in Mongolia or Zambia, and only a notch or three easier than in Jamaica, Albania and Pakistan. That might be the most ominous portend of all.

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